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U.S. Bureau of Foreign
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Title:

Factors affecting foreign
trade policy

Place:

[Washington, D.C.]

Date:

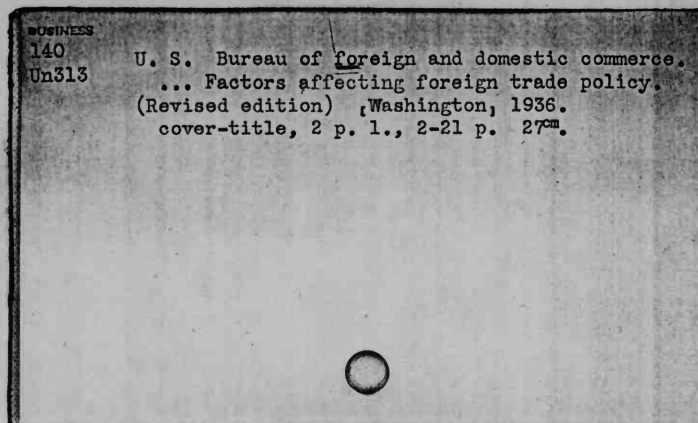
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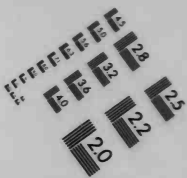
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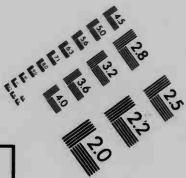
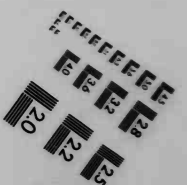
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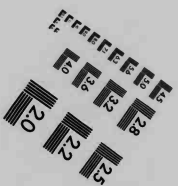
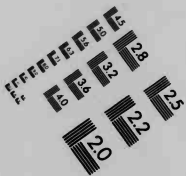
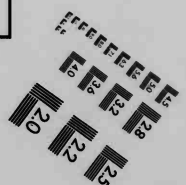
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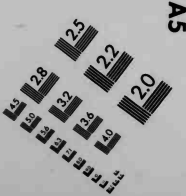
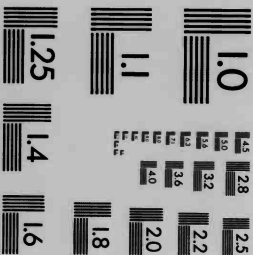
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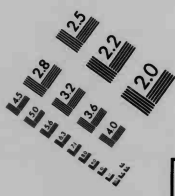
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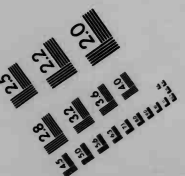
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FACTORS AFFECTING
FOREIGN TRADE POLICY

(REVISED EDITION)



MAY 1936

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122 Oct. 14, 1936

LETTER OF TRANSMITTAL

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Business

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Secretary of Commerce
Washington, D. C.

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LETTER OF TRANSMITTAL

DEPARTMENT OF COMMERCE
Bureau of Foreign and Domestic Commerce,
Washington, D. C. May 1, 1936.

Sir:

The present report is a revised edition of a study of the outstanding factors affecting the foreign trade of the United States undertaken at the suggestion of the Foreign Trade Committee of the Business Advisory Council for the Department of Commerce with the primary purpose of providing a factual basis for the determination of a sound foreign trade policy. In the preparation of this report the various experts of the Bureau have, therefore, endeavored to describe clearly and objectively the major forces which are now influencing international commercial relations.

A study of this character gains added significance from the fact that the attention of the American public is being directed anew to the importance of foreign trade, not only by the reciprocal trade negotiations now in progress but also by the plans for observing "Foreign Trade Week" on a nation-wide basis during the period May 17 to 23. One of the principal objects of "Foreign Trade Week" is to emphasize the fact that the development of our foreign trade along rational lines can, and should, play a leading part in economic recovery.

It is hoped that this report will contribute toward a clearer understanding of present-day problems in international trade and will assist in the formulation of a consistent foreign trade policy for this country.

ALEXANDER V. DYE,
Director.

Hon. Daniel C. Roper,
Secretary of Commerce,
Washington, D. C.

MEMORANDUM ON FACTORS AFFECTING FOREIGN TRADE POLICY

PREFACE

The cumulative force of the economic and social disturbances resulting from the war and the postwar developments has produced a radical change in the whole international economic environment. Foreign trade, as the most important form of international economic relationship, has been most vitally affected. The economic disturbances, from which all countries of the world are still suffering, are not merely the result of the waste of war, but also represent the maladjustment introduced by the accelerated rate of technical progress, quicker transportation and communication, and the more rapid shifts in consumers' habits. Consideration must also be given to the social and economic disequilibrium between production and distribution, and to the new political forms created by the economic stress. All these factors serve to shape the new environment for foreign trade, and it is, therefore, of the utmost importance for business men to understand the new forces so that they can make an intelligent contribution to the working out of a new foreign trade policy for the United States adequate to meet the new conditions. The present memorandum is intended to give an exposition of the basic factors in international trade, with an emphasis on the foreign trade position of the United States.

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GOVERNMENT INTERVENTION AND ECONOMIC NATIONALISM

During the early stages of the depression many economic students were thinking and planning on the assumption of a return to what had come to be considered as normal economic conditions. By "normal" in international economic relations was meant substantially a condition where foreign trade would be based primarily (1) on competitive advantages, with merely the ordinary interference from tariffs and sanitary restrictions; (2) on a movement of capital actuated by such economic factors as exploitation of natural resources or the operation of public utilities; and (3) on a monetary stability sufficient to provide a basis for long-time operations. It was tacitly assumed that since most of the war-time restrictions had been eliminated, there was no reason to expect a different ending for a mere economic depression. The reparation problem was on the way to settlement; the war-debt problem was not so far advanced toward a solution, but was not expected to result in a serious international disturbance. The more thoughtful, or perhaps the less optimistic, observers were somewhat disturbed by the artificial factors underlying our own boom and were particularly dubious about the soundness of our foreign investments as well as the discrepancy between our creditor position and our favorable trade balance.

As the depression deepened and the manifestations of economic nationalism became more frequent and disruptive to international trade, it became evident that the whole economic environment was undergoing fundamental changes. The uninterrupted succession of trade restrictions, the irrational attempts to confine the remnants of foreign trade within the strait-jacket of barter and clearing arrangements, the various government debt defaults, and the climax of the German revolution with its economic consequences, have clearly demonstrated the unwisdom of relying too much on mere economic factors. Some of the most important countries of Europe are consciously resorting, under political and social pressure, to policies which under normal conditions would be recognized as fundamentally unsound. A country like England, which has for years been investing enormous amounts of capital to develop new and cheaper sources of foodstuffs and raw materials in foreign markets to supply a strong base for British industry, now finds itself compelled to restrain the abundant flow of goods to its market, in order to protect its own comparatively small agriculture or in answer to the pressure from the dominions. Germany, under political pressure, finds it necessary to establish what practically amounts to the economy of a closed state, with many measures bearing the earmarks of war-time legislation. The tremendous assets represented by shipping, export industries, and international banking are sacrificed or subordinated. The same applies, even to a greater extent, to Italy.

Under the circumstances, the strengthening of economic nationalism is inevitable. If a country cannot sell abroad, it is unlikely to buy, and if it cannot afford to import the superior foreign product, it is a part of political expediency to get the people to believe in the superiority of the domestic substitute or in the patriotic duty to accept an inferior domestic product or go without. The cumulative effect of such tendencies is the reduction of foreign economic intercourse to necessities and a gradual deterioration of the standard of living in all countries.

Paralleling this tendency toward economic isolation, there has developed in many countries a definite policy on the part of governments to intervene more directly in the economic

life of the people. While this movement cannot be ascribed entirely to the present depression, considering the situation in Russia, Germany, and Italy, there is no doubt that the financial and industrial difficulties resulting from the depression have served to strengthen the participation of the government in industry and finance and have led to government financial control of leading industries and financial institutions. This is particularly true of Italy and Germany.*

In Germany government participation in economic life is not a recent development. Municipal socialism had reached a considerable degree of development even prior to the war, and a number of German states owned and operated mines and certain public utilities. The war, with the resulting economic blockade, greatly intensified that tendency and the government not only was compelled to assume control over essential industries and channels of distribution, but also was forced to go into production in order to supply important commodities for national defense. This is particularly true of the aluminum industry, which even now is, to a very large extent, controlled by the government. During the socialistic regime, following the revolution, the general socialization law of March 3, 1919, became the basis for subsequent legislation providing for compulsory cartelization of certain key industries. The complete cartelization of such industries as coal and potash, under government supervision, dates from that period. Subsequent political developments prevented the Socialist Party from following up the policy inaugurated during the "socialization" era, and for a time there was a decided reaction against government intervention, and the state made an effort to liquidate some of the industries built up during the war or under the disarmament provisions of the Versailles treaty.

The disastrous effect of the depression on German banking and industries has forced the government to reverse its policy, so that at present its control of certain phases of industry, and particularly of banking, is greater than ever. During the banking crisis of 1931 the government had to intervene through the Reichsbank, and the government-owned Golddiskontbank, first by a guarantee and later by providing a large share of the new capital. Even when the largest German bank (Deutsche Bank and Disconto-Gesellschaft) was compelled to reorganize and obtain new capital, the government had to take up a considerable share of the new issue. In the industrial field the outstanding instance of government control was furnished by the acquisition in 1932 of the majority control of the Vereinigte Stahlwerke, the largest unit in the German iron and steel industry, responsible for about half of the total output of the country, and exercising a controlling influence in the Ruhr coal situation. A still further extension of government control over the German coal situation was involved in the acquisition, toward the end of 1932, of control of the Rheinbraun-Gesellschaft by the Rheinisch-Westfaelische Elektrizitaetswerke, in which Prussia and some of the larger municipalities are the chief shareholders. These instances of direct financial control by the government of an outstanding industry differ somewhat from the guarantees and subsidies granted by the government to certain industries like shipping, copper and zinc production, and to agriculture, which have characterized the economic policy of the German government for years, but which have become intensified during the depression.

* Russia is omitted on account of the socialized character of its economy.

The new German regime, in spite of its hostility to socialism and communism and its actual surrender of financial control over the iron and steel industry, has gone very far in the direction of government interference with economic affairs. There is now a very strict control of production and distribution of foodstuffs, the prices of all commodities, industrial expansion, distribution channels, wages and profits, banking and finance, in addition to the absolute control of foreign trade through numerous measures of exchange control, clearing and barter arrangements. The fact that most of the heavy industries owe a large share of their activity to government orders connected with the public work and rearmament policies, and depend for their financing largely on government-controlled banks or government short term bills, adds another very important element to the government intervention situation. Under the present political regime in Germany, with the utter absence of any limitation on the powers of the government, it may be said that there is practically no separation between business and government.

In Italy, where the fundamental idea of the corporate state implies direct action by the State in so shaping economic policies as to subordinate private interests to national welfare, it is quite natural that the period of economic distress should serve to strengthen the hold of the government on economic life. Thus, in 1931, the government found it necessary to organize a special institution to take over the industrial-share portfolio of the largest Italian bank engaged in industrial financing, as well as to finance industries through the issue of bonds on the basis of the industrial shares taken over. While such an institution does not differ essentially from our own Reconstruction Finance Corporation, it must be regarded in the light of the general economic policy of the present Italian government and the relative scarcity of capital in the country. In other words, a step of that kind by the government, which may be a mere emergency measure in the United States, where private domestic capital is the predominant factor in industrial financing, may represent a much more permanent change in a country where, under normal conditions, industry was financed to a substantial extent by foreign capital. It is hardly to be expected that the Fascist State, with its strong nationalistic leanings, would allow foreign capital to recover its old status in the country, or that Italian industry will be allowed to make such high profits as to enable it to buy out the government. In addition, mention should be made of the heavy financial interest of the government in shipping; the wheat policy, which places the wheat import trade on a more or less political basis; the law providing for compulsory cartelization of industries and preventing any new construction or expansion without government permission. And, finally, the recent action of the Italian government in nationalizing the key industries essential to national defence, while proclaimed as a result of a national emergency, raises some doubts as to the future of private economy in the Fascist State.

Neither England nor France has gone as far in the direction of government control as the above countries. In both countries, however, there is a perceptible tendency in that direction. In France it has taken the form of government ownership of certain industries, like synthetic nitrates and oil refining, of national-defense importance, and the control of wheat prices and proposed monopoly of the distribution of petroleum products. In England, one may cite measures for the control of domestic agricultural prices and the government intervention in the coal industry, as regards prices, working conditions, and amalgamation, under the Coal Mines Act of 1930.

The Scandinavian countries, despite their liberal economic traditions, have also found it necessary to adopt many measures of State control over economic affairs. In Japan, where the whole economic development of the country has been closely tied up with State assistance and participation, the abnormal international situation has naturally served to strengthen that tendency to a high degree.

SELF-SUFFICIENCY MOVEMENT

The trend toward self-sufficiency started long before the depression and can be traced primarily to the World War. The disruption of international economic relations caused by the great struggle compelled many countries, belligerent and neutral, to build up domestic sources to replace those cut off by the war, to meet the increased demand for military purposes, or to furnish occupation to labor thrown out of employment by the war restrictions on commerce. During the postwar period, many countries found it impossible to abandon the numerous uneconomic enterprises started under abnormal conditions, without adding to the economic dislocation; some considered it necessary to continue them for purposes of national defense; and others were compelled to retain them under social and economic pressure created by the unfavorable position of agriculture and by industrial unemployment.

In addition to the factors mentioned above, there was also the impetus given to industrial development in a number of foreign countries by the postwar movement of American capital, which helped to finance the branching out of American industries and utilities. The extensive branch-factory development in Canada, Europe, and elsewhere, and the large investments of American capital in the public utilities and in the exploitation of mineral resources in Latin America, are striking manifestations of that trend. It should also be pointed out that the technical changes in certain industries and the development of automatic machinery have in themselves tended to bring about a greater distribution of industrial development and have made it possible to transplant some very complicated industries, like the automotive and rayon, to comparatively undeveloped countries. Incidentally the industrialization of new countries temporarily promotes sales of machinery and equipment by the older manufacturing nations.

The development of new nations following the Versailles and Trianon treaties is a factor that has intensified greatly the self-sufficiency impulse, besides complicating the problem of international trade restrictions. Most of the small new nations, jealous of their achievements in statehood, have striven assiduously to develop artificial economic autonomy with inadequate regard for economic facts.

The trend toward self-sufficiency somewhat slackened during the first stage of the depression, but the countries that have gained in industrial development with the aid of foreign capital are not likely to return to their prewar position of mere producers of foodstuffs and raw materials; many of them have shaped their tariff policies so as to protect the newly established industries and to attract more capital for industrial development.

With the deepening of the depression and the consequent spread of currency disturbances and exchange and trade restrictions, which have done so much to demoralize foreign trade, a new impetus was given to the self-sufficiency trend, by intensifying the protection of domestic markets. And, finally, the recent political developments in Italy and Germany and the repercussions of the present international political situation on military and naval preparedness have served to give still greater emphasis to the political significance of national self-sufficiency and have greatly increased the State's assistance to essential industries.

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THE MOVEMENT OF PRICES

Prices in international trade have been declining steadily since 1929. For a few commodities the downward movement started in 1928. The rate of decrease slackened in 1933, when the level of world prices was more than 50 percent below 1929, but the decline continued until about the middle of 1935. Since that time prices have been rising slowly. In the first half of 1935 the general average of prices was slightly over 3 percent below 1934; in the third quarter of 1935 prices were about 1 percent, and in the fourth quarter about 3 percent, higher than in the corresponding periods of 1934.

The principal commodities imported into the United States which increased in price in 1935 were rubber, silk, jute, manila hemp, sugar, copra, and tung oil, while coffee, tea, linseed, and tin declined. Among the leading commodities exported, lard, flour, fruits, leaf tobacco, copper, and various manufactured goods increased in price, while barley, oil-cake, lumber, coal, and paraffin declined. With a few exceptions, however, the increases or decreases in the prices of individual commodities were small.

The general level of prices is still more than 50 percent below the level of 1929. The increases in the second half of 1935 were only to a small extent caused by monopoly control or speculation; they were due chiefly to the increased turnover which naturally brought about an improvement in prices, particularly in the case of staple commodities where prices had been abnormally low. Between 1929 and 1934, for example, the gold price of American lard exported went down from 12.72 to 3.64 cents, and the price of raw silk imported from \$4.91 to 66 cents a pound — in 1935 the price of lard was more than doubled at 7.30 cents, while the price of silk rose to 84 cents.

Apart from the natural effects of the ratio between supply and demand, prices in international trade have been affected by monopoly control, speculation, and various artificial restrictions. A new disturbing factor has now appeared — the war of the currencies. In attempts to adjust domestic costs of production to the lower world-trade prices, a number of countries have substituted paper currency for gold. A few of these currencies are fairly stable; most of them are depreciating slowly but steadily. The benefits supposed to be derived from a depreciating currency are largely illusory, as the temporary advantages offered to exporters may be offset by disadvantages to importers, and the constant fluctuations in exchange make calculations more difficult and increase the risks of trade. An international currency reform would seem essential for a restoration of international trade.

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IMPORTANCE OF FOREIGN TRADE IN NATIONAL ECONOMY OF THE UNITED STATES

Foreign trade has always been an important factor in the economic well-being of the United States. The same features of our economy which have contributed to our unexampled industrial growth have rendered the continuation of international intercourse essential to our prosperity. A bountiful supply of rich natural resources and a variety of climatic conditions in this country led to an early development of the division of labor and specialization of industry, accompanied by improved means of transportation and the wide-spread use of machinery.

Just as wide markets have made the division of labor and the use of machinery possible, the division of labor and the use of machinery have made wide markets necessary. Because of this fact we find it profitable to concentrate upon those goods in the production of which we possess a relative advantage and to import chiefly those which may be more economically produced in foreign countries. Since all our industrial growth has taken place in contemplation of this fundamental principal of comparative production advantage, anything that disturbs the flow of our trade to and from foreign countries affects our economy adversely. Although the original impact of a disturbance may affect some industries more directly than others, unbalancing vibrations are transmitted through curtailed production, unemployment, reduced profits and purchasing power, so that many industries invariably become involved.

Imagine the distress which would have befallen the southern cotton farmers, and through them transmitted to merchants, manufacturers, and laborers throughout the country, if \$391,000,000 worth of cotton had not been sold in foreign markets in 1935. Think of the machinery industry without its sales abroad of \$265,000,000 worth of machinery, or the oil industry without its foreign sales of \$249,000,000 or the automobile industry bereft of a foreign sales amounting to \$227,000,000.

Hardly less disastrous would be the cutting off of foreign sources of many products which we cannot produce economically at home. No section of the United States possesses the climatic and soil conditions suitable for producing the \$137,000,000 worth of coffee we imported in 1935. Sugar would have been so dear that its use would have been seriously curtailed if we had not imported \$133,000,000 worth of cane sugar. Imagine the price of automobile tires if we had not imported \$119,000,000 worth of crude rubber. Certainly we would have been unable to export \$22,000,000 worth of rubber manufactures.

In 1935 we exported \$2,282,000,000 worth of merchandise. Of United States merchandise exported, 30 percent consisted of crude materials which we can produce cheaper in large quantities than can other countries. Another 60 percent of our exports consisted of semi- and finished manufactures in which were embodied the economies of our large scale machine production. We exported in the latest years for which figures are available, 50 percent of our annual production of cotton; 36 percent of our tobacco; 40 percent of our dried fruits; 65 percent of our patent side upper leather; 51 percent of our gum rosin; 30 percent of our lubricating oils; 36 percent of our lubricating greases; 66 percent of our refined copper; 14 percent of our radio apparatus; 23 percent of our power driven metalworking machinery; 35 percent of our sewing machines; 39 percent of our printing and book binding machinery; 27 percent of our office appliances; 30 percent of our agricultural machinery; 21 percent of our tractors; 37 percent of our aircraft; and 43 percent of our borax. We regularly export from 7 to 10 percent of our total production of movable goods. The loss of from 7 to 10

percent of our markets would spell disaster to our economy and the uneven effect upon different industries would result in industrial chaos.

Our imports of merchandise amounted to \$2,047,000,000 in 1935. Twenty-nine percent of our imports for consumption consisted of crude materials, some of which we do not produce at all in this country. Another 31 percent consisted of foodstuffs. Some of the commodities of this class were of tropical growth while some were competitive in character and merely supplemented our inadequate home production. Twenty percent of our imports consisted of semi-manufactures for further processing by domestic plants, and 20 percent consisted of finished manufactures which could be produced cheaper abroad than at home.

Because foreign trade involves the exchange of merchandise across political boundaries and is consequently influenced by tariffs, exchange fluctuations and political policies, there is always a strong tendency to regard foreign trade as peculiarly removed from domestic trade. This view often overemphasizes the difference between the two types of transactions and minimizes the great number of influences which affect both forms of trade simultaneously.

Foreign and domestic commerce are closely interrelated parts of a complicated whole. Both have traversed the same general course throughout our history. They expand and contract with a remarkable sympathy. Both reached a peak in 1929 and both declined to a low in 1932. Both have been improving since that year.

In 1935 the substantial improvement in domestic economic activity was accompanied by a 7 percent increase in the value of our exports and a 24 percent increase in the value of our imports over the preceding year. Most of the increase in exports was accounted for by an increase of approximately 13 percent in the quantity and finished manufactures exported which roughly paralleled the 14 percent increase in the volume of industrial production.

The increase in imports in 1935 was on the whole fairly evenly distributed among all classes of commodities. Imports of semi-manufactures for further processing were up 33 percent in value. Crude materials imports, to meet the needs of expanding industry, increased 26 percent. Imports of crude foodstuffs increased 27 percent, and manufactured foodstuffs 21 percent. Imports of finished manufactures were 16 percent larger than in 1934.

Early figures on the trade in 1936 presage a continuation of the upward trend. Exports in the first quarter have been approximately 10 percent larger in value than in the first quarter of 1935. Imports in the first quarter of 1936 have exceeded those of the corresponding period of 1935 by approximately 15 percent. Although still far below the peak year 1929 in terms of value, exports in the first quarter of this year have been 1.4 percent larger and imports 112 percent larger than in the low first quarter of 1933. In view of the fact that the welfare of millions of people in the United States depends directly or indirectly upon the continuance of foreign trade the improvement of the trade in the past few years is of greatest significance.

A highly developed industrialism, in the United States as elsewhere, requires markets which transcend political boundaries and reach to all corners of the world. The urge for greater efficiency and lower cost of production leads to specialization, which in turn demands broad markets if maximum benefits are to follow. For some commodities nothing short of a world market justifies specialization and mass production with their accompanying economies

THE QUESTION OF A RECIPROCAL TRADE MOVEMENT

During the past two decades, the United States has drastically altered its international commercial and financial position, in that it has become a great creditor nation instead of a debtor country, as formerly. Creditor countries, obviously, must be ready and willing to accept the logical consequences of that creditor position — consequences which, when rightly viewed, are seen to be as beneficial as they are inescapable. If a creditor country expects to continue to export merchandise in large volume and receive interest and repayment of principal on its loans — it must be prepared to take payment in goods or services when necessary. That inevitably means an increase in imports.

The United States is favorably situated to embark upon the rational and advantageous policy of encouraging reciprocal trade. Our international trade position puts no compulsion upon us to restrict our foreign trade. Our exports are still considerably higher than our imports (as already indicated in an earlier section of this Memorandum) although both together have descended to a relatively low level. There is no danger, therefore, that we may be short of the necessary foreign exchange to pay for imports, with attendant reduction in our monetary reserves. Many other countries that have trade barriers have erected these because they cannot find means to pay for their imports. Our tariff barrier was established because of an apparent unwillingness to take payment in the only ways in which it is feasible for foreign debtors to make such payment to us.

Any person having merely a casual acquaintance with the thorny difficulties involved in international "transfer problems" knows that foreigners cannot pay indefinitely for their purchases of American commodities by actual physical shipments of gold to cover any substantial part of the amounts due. Any such attempt is impracticable and would be disruptive in effect.

If, then, we accept the desirability of our receiving imports from abroad, there are two principal factors that need to be considered. The first is the need of following the principle of scientific selection in controlling the character of our import trade. The second has to do with the extent to which foreign investments and tourist expenditures may be substituted for commodity imports.

As regards the selection of our imports, it is proper to place first emphasis on the goods that we need as raw materials, as, for example, rubber, silk, and certain minerals. A second classification about which there should be little dispute consists of important foodstuffs such as coffee, tea, sugar, and certain tropical fruits. Beyond these two classifications, the acceptability of foreign products depends upon the extent to which they are competitive with American-made goods. If, in certain lines, our own products are entirely adequate and properly priced, the presumption is in favor of retaining tariff protection — the degree of protection, of course, being conditioned upon many factors.

Too strict a definition cannot be given to "competition" as it relates to foreign-made goods. Most commodities have a wide range of quality and style elements. From the standpoint of the consumer, a difference of color or pattern or finish may be enough to constitute, for his particular purposes, an entirely new commodity. Differences of this sort

which satisfy the discriminating tastes and varying inclinations of the people are the factors that make possible a wide range of consumption goods. Such subtle differences are as likely to be found in foreign as in domestic goods.

The so-called economic "needs" of a country cannot justly be considered as absolute and fixed. They are, on the contrary, relative and continually changing — ever moving upward from the most basic wants to those which lie in the upper levels of human desire. In a country which is truly prosperous and in which popular incomes are above subsistence levels, the needs of individuals become more and more those having to do with comforts and tastes which, if viewed from a lower stratum of economic well-being, might appear to represent extravagant luxury.

These pertinent facts must be given due weight in making decisions as to admissible imports.

Our import policy may be qualified, secondly, by our foreign-investment policy. The first result of foreign loans is to increase exports, but the secondary result, if the lending country is to receive interest and repayment of principal, is an increase of imports of either goods or services.

Another significant consideration has to do with the expenditures of American tourists in foreign countries. During our most prosperous years such expenditures reached the enormous annual total of about \$800,000,000. In recent years, they have been materially less. In an economic sense, these expenditures are of course the exact equivalent of imports.

AMERICAN COMMERCE AFFECTED BY TRADE POLICIES OF FOREIGN NATIONS

The United States has ranked second only to Great Britain among the leading foreign-trading countries; it had for years been exporting perhaps the broadest range of diversified natural and manufactured products of any country, and trading in some measure with all markets of the world. Our exports have shrunk more since 1929 than those of any important country, as a result both of the general depression and of the cumulative rise of import barriers, by devices new and old. (Beginning in 1934 and accentuated in 1935, there has been some recovery in United States exports, although thus far it has been moderate in quantity and represented mostly enlarged exports of manufactured products.) The depression years have seen not only further increases in the import duties of most foreign countries, but also the resort by many governments to quantitative limitations either upon the amount of particular classes of products allowed to be admitted as a whole or from different countries (commonly referred to as "import quotas"), or upon the amount of foreign exchange which the central authorities would allot for the payment of particular purchases from abroad or other obligations due citizens of foreign countries (commonly known as "exchange controls").

Against most of these new or increased trade restrictions, as well as against the trade-diverting effect of special agreements between various foreign countries, the United States Government has been rather helpless. This has been due to the fact that, until June 1934, the American tariff system had been inflexible, and our government had not been vested with authority to grant concessions in the duties on selected products of particular interest to foreign governments in return for corresponding concessions in their tariffs and other trade restrictions that might enlarge the particular market for distinctive or surplus American products. The recent developments in the tariffs and trade-control policies of foreign governments are, therefore, of particular interest to the United States. Since the general trend in this field during the depression years is fairly well known, the discussion here will be focused upon the trends of the past year or two, as indicative of the conditions under which our efforts for revival of American foreign trade must proceed.

The years 1934 and 1935 have seen much activity abroad, in the changing of tariffs, the adjustment of import quotas and exchange allotments, and in the negotiation of trade agreements between various sets of foreign countries. Allowing for certain exceptions, however, the net outcome appears to have left the general trade-control structure of the world as a whole about as restrictive as it was. Particularly on the Continent of Europe, the situation has, in a measure, become even more complicated because of the very developments of the last two years, notably in Germany and Italy. Outstanding among the developments in the opposite direction has been the easing of the restrictive effect upon foreign trade of the exchange-control systems in a number of important Latin American countries, and some gradual progress in a few countries toward more liberal and more stable conditions of admission for imports, mainly as a result of certain reciprocal trade agreements, especially those with the United States.

The beginning of general economic recovery experienced in varying degree within many countries, during the past two years, has thus far been accompanied by very little expansion of world trade as a whole, as measured by the aggregate quantity of distinctive or surplus

products of each country that was enabled to find markets in the territories of other countries. The fact that the progressive shrinkage of foreign trade which has been going on since 1929 has been checked recently, and that some recovery has taken place here and there, is encouraging. It is also noteworthy that the fluctuations in exchange rates between the currencies of the major groups of countries — the essential monetary mechanism for adjustment of all international transactions — have been kept within relatively narrower limits during 1934 and 1935 than the years immediately preceding. However, the lag behind general economic recovery within most countries and the slower revival thus far of their exchanges with other countries appears attributable, at least in part, to the absence as yet of any material change from the spirit of intense nationalism and from the practice of tight governmental restriction of imports that has characterized the trade regime of most countries during the last few years.

Despite many conferences between various groups of countries looking to collective action of a trade-liberating character, and the attempted beginnings of such concerted efforts in a limited way, the practical results thus far from international agreements have been of little general significance. The majority of the foreign trade-control measures adopted by individual countries during recent years have continued to be dominated by the protective and restrictive motive. Immediate relief from current local pressures has been the dominant objective, with comparatively little recognition that there are distinct limits to recovery through expansion of the home market only — a recognition that is essential to the rebuilding of a long-time basis for a broader flow of international trade.

The modifications in trade-control measures that have issued from bilateral agreements between various pairs of countries during recent years, have too often been trade-diverting in effect, rather than trade-enlarging. Moreover, in a striking proportion of instances, such agreements seem likely to weaken and to disorganize rather than to strengthen the network of triangular or many-sided transactions, the operation of which over past decades has been such a vital factor in the economic development attained by the different countries, and in the building up of the huge aggregate pool of world commerce, the benefits of which flowed back to all contributing countries, irrespective of the variations in the currents between individual countries.

A most disturbing feature of the recent commercial policy of many foreign governments has been the increased prominence of the idea that the value of the trade between each pair of countries should approximate an annual balance. For various reasons arising out of the prolonged general depression, marked as it has been by the great shrinkage in foreign trade, the disorganization of international currency values and exchanges, and the practical cessation of international large-scale lending, the concern of a great many foreign governments, especially on the Continent of Europe, has recently been centered upon the improvement of their balance of trade, and thereby also of their foreign-exchange rates and general financial position. This has often seemed more important to them than the usual motives of protection to domestic producers from undue foreign competition, or increased governmental revenues, or even the desire to attain greater domestic self-sufficiency in certain commodities.

The numerous exchange clearing arrangements and compensation agreements entered into by most of the European countries with each other and with a number of the Latin American countries, represent an important mechanism by which many nations have been trying to give effect to this general objective of improving their total trade balance, through fixing a compensatory relation or a particular ratio in the volume of goods exchanged with each other country. However, these clearing and compensation agreements, which have been especially common in Central Europe, are reported not to be working out very satisfactorily.

Aside from the administrative difficulties involved, it appears that, where an approximate balance in the trade movements between a pair of countries has been attained, it has usually been closer to the level of the lower rather than the higher previous current of trade. It seems significant that, on the Continent of Europe, where for several years there has been more intense activity than anywhere else in the negotiation of special commercial agreements and trade-balancing arrangements, the aggregate foreign trade ran materially lower (in gold values) during the months of 1935 than during either 1934 or 1933, while the corresponding foreign-trade movements of other parts of the world either held their own or improved in value over previous years.

It may well develop before long that bilateral balancing and compensation agreements will be more widely recognized as ineffective as a means of increasing the aggregate volume of a country's exports and, therefore, not to be regarded as desirable instruments of normal commercial policy.

These recent developments and trends in the tariffs and commercial policy of foreign countries give particular point to the program initiated by the Government of the United States, under authority granted by Congress in June, 1934, for the negotiation of trade agreements with foreign countries involving the reciprocal reduction of tariffs and other trade barriers now unduly restricting the sale of each country's products in the market of the other. The sponsors of this program hope not only to revive the flow of international trade through a progressively growing series of reciprocal trade-liberating agreements, but also to give a distinctly new turn to commercial policy of the nations generally, toward regaining the benefits of a broader flow of international exchanges on a more sound and equitable basis. (For an analysis of the American trade agreements program, its procedure and progress to date, see pages 20 and 21 .

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FINANCIAL POLICIES AFFECTING INTERNATIONAL TRADE

Outstanding Monetary Measures and Tendencies

The breakdown in the international monetary mechanism which occurred following the financial crisis in Central Europe in May-June 1931, and the suspension of the gold standard by Great Britain in September of that year, has had such serious repercussions that no forecast of the future course of international trade can be made without considering this factor.

The climax in the disintegration of the traditional monetary mechanism may be said to have been reached in April 1933, when the United States placed an embargo upon the exportation of gold and thus took its first definite step toward suspending the gold standard.

In the summer of 1933, following the World Economic Conference at London, a group of European countries which still adhered to the gold standard banded together for their mutual aid in the retention of this standard. They were France, Belgium, the Netherlands, Italy, Switzerland, and Poland. Italy has since abandoned the gold standard, and Belgium has devalued its currency by 28 percent.

Besides the "gold bloc" there may be said to be two other distinct currency groups. The sterling-area countries are the most important of the three, for this group includes not only Great Britain and its dominions and colonies, with the exception of Canada and Newfoundland, but also Portugal and the Scandinavian countries. Since the official rates of exchange in Japan, Argentina, Chile, and certain other countries are based on sterling, the sphere of influence of that currency is very wide.

Although the United States has been on a modified gold standard since January 31, 1934, it has pursued a policy different from that of both the "gold bloc" and the sterling group. A number of countries whose economic life is closely dependent on the United States may be considered as belonging to the "dollar bloc". This group includes the countries of Mexico, Central America, Colombia, Venezuela, and those of the West Indies which are not possessions of European powers. It should also be noted that for more than two years, the Canadian dollar has been held very close to its former parity with the United States dollar.

In November 1935, China, which had in fact been off the silver standard for over a year due to the embargo on silver exports, joined the large number of countries with managed currencies.

It is clear in any event that for more than four years there has been no international monetary system comparable to that which the world enjoyed during the period prior to the World War and which was restored for a time in the latter part of the 1920's.

Nevertheless, international trade has continued in substantial volume. The explanation of this lies partly in the fact that many countries, particularly those which found it impossible to maintain the free functioning of the foreign exchange market, have been able to keep certain channels of trade open through the conclusion of bilateral clearing agreements. The international exchange of goods has also been facilitated by the existence of

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large exchange equalization funds in Great Britain and the United States. These funds have operated fairly satisfactorily although with periodic uncertainty as a stabilizing element in the clearance of international transactions. The countries in the various currency groups have not only found it possible to keep within comparatively narrow limits the fluctuations in the rates of exchange for their own currencies but, in addition, the groups themselves have as a rule found ways and means to avoid excessive fluctuations between the dollar and the pound and between the pound and the franc and other "gold bloc" currencies.

The rates of the pound sterling in terms of dollars during 1935 ranged between a low of \$4.7408 (March 12) and a high of \$4.9828 (August 20). The Paris "closing-rate" on London in francs per pound sterling varied between a low of 70.56 and a high of 75.50 in 1935.

In view of the disturbing political events in Europe during 1935, the fluctuations of the pound in terms of the dollar and in terms of the French franc have not been so wide as might have been expected in the absence of an international monetary mechanism.

The point of the foregoing discussion is not that marked progress has been made toward establishing an international monetary system but merely that arrangements have been effected which permit the clearing of international transactions with a fair degree of regularity and effectiveness.

The continued functioning of the exchange on any satisfactory basis cannot, however, be assumed. For many months there has been serious doubt as to the ability of the "gold bloc" countries to withstand the strain which adherence to the gold standard entails.

It is generally agreed among world statesmen, scholars, and business men that action should be taken to bring the currencies of the leading countries into some definite form of equilibrium. It is desirable that the relationship of international currencies be established upon a basis inspiring more confidence than the present improvised system of clearing agreements between nations in order that the total volume of world trade may continue to expand.

Managed Currencies

The countries in the sterling area are generally regarded as having "managed currencies" in the loose sense in which that term is commonly employed. "Management" of the currency has been achieved directly, as in the case for example, of Great Britain and Sweden. These countries, by their central-bank, credit, and other policies, have kept the level of internal commodity prices fairly stable. Management of the currency has also been accomplished indirectly as in the case of those countries which have pegged the value of their currencies in terms of sterling or, in some cases, the dollar. In the absence of a monetary standard, recourse to some form of "management" of the currency has been imperative in various countries.

Buttressed as that policy has been by trade agreements, such as the Ottawa Agreement and by trade agreements between Great Britain, on the one hand, and Denmark and Argentina, on the other, it has undoubtedly stimulated trade among the members of the sterling bloc. It should not, however, be overlooked that these trade agreements are, for the most part, regarded as temporizing arrangements, forced by international monetary disturbances and by experiments in the field of economic self-sufficiency; and that they are not wholly satisfactory to their intended beneficiaries.

INTERNATIONAL CAPITAL MOVEMENTS

Investments and Loans

International trade for more than a century has been stimulated and supported to a considerable degree by the international movement of capital, in the form of direct investments and of long-term loans.

The world economic system has operated in the past — particularly in the pre-war period — on the basis of a fairly free flow of capital from the older and more highly developed countries, which have a surplus of capital over domestic requirements, to the newer countries which have need of capital for the proper development of their natural resources.

The international flow of capital has been interrupted in periods of world-wide business depression, as in the late 30s, the 70s, and the 90s of the 19th century. The interruption caused by the present depression is perhaps the most serious of all, even for the United States, although its present position is that of a world creditor instead of that of a world debtor, as in the previous crises.

The international monetary mechanism was in a highly vulnerable position when the break in business confidence occurred in 1929-30. The structure of world trade had become adjusted to the extraordinary outflow of capital from the creditor countries during the period 1922 to 1929, and, as a result of these and earlier capital movements, a tremendous volume of international indebtedness had been built up, entailing heavy interest and amortization payments by the debtor countries.

After 1930 capital movements for purposes of long-term investment declined rapidly until they reached negligible proportions, and there has been a rapid, sometimes panicky, withdrawal of funds previously invested. It is important to note that present-day capital movements, instead of being based on the relative income yields of various fields of investment, tend to be motivated in many cases by considerations of safety and of speculation. This change in the character of international capital movements is evidenced by the almost complete absence of new flotations of foreign securities and by the dominant role played by short-term capital movements and by international trading in equities as contrasted with that in bonds.

These sudden shifts in the direction and nature of international capital movements led to the financial crises in Austria, Germany, and England in 1931 and, together with the weaknesses in our banking structure, contributed to the financial collapse in this country in the early part of 1933. At various times they have seriously menaced the position of the gold bloc countries.

The shocks resulting from these abrupt shifts in the flow of capital have been partly absorbed, and in some respects the danger of future disturbances is less. The volume of international indebtedness has been scaled down through repayment or repatriation of a fairly large amount of foreign loans. In other instances loans have been refunded at lower interest rates and the face amount of a few obligations has been reduced. However, an important

task remains in the adjustment of the defaults on interest payments which occurred during the worst periods of stress.

The problem of huge liquid balances held by foreigners in the United States has been eased up. From a peak of more than three billions at the end of 1929, the total amount held here by foreigners in bank balances and other short-term investments in dollars declined to \$427,000,000 at the end of 1933. The corresponding figure for the end of 1935 was \$1,155,000,000. Large balances of this type remain in London, Paris, and to a lesser extent in Zurich and Amsterdam, and their mobility continues to be a threat to such stability as international exchange now has. But the harm which they can do through sudden shifts from one money market to another can likely be kept within bounds by exchange equalization fund operations.

Likewise, the extraordinary amounts of foreign short-term loans and credits which were largely immobilized under "stand-still agreements" in Germany, Austria and Hungary have been greatly reduced, although with some grave disturbances, in the case of Germany, to the payment of long-term debt and commercial obligations. Austria has cleared up most, if not all, of the foreign credits which the Credit-Anstalt had outstanding in February 1931.

In 1934 Canada, Austria, Finland, Argentina, Norway and Sweden redeemed long-term dollar loans aggregating \$166,000,000, and about \$145,000,000 of other dollar loans were retired by sinking-fund operations.

Commercial Credit

In view of the uncertainties as to the future course of exchange rates as well as of the effects of exchange controls, international trade has lacked the support which it has been accustomed to derive from the extension of commercial credit from banks and acceptance houses.

Reparations

One effect of the breakdown of the international monetary mechanism and of other factors has been the elimination of reparation payments as a burden on the international exchanges. If, as many believe, international lending on a large scale was required, directly or indirectly, to enable reparations payments to be made in the past, the elimination of such payments will reduce the needs of international financing by just so much in the future.

War Debts to the United States

There remains, however, the question as to whether the United States will continue to insist upon the payment of the war debts as funded or will at an opportune time in the future agree to a substantial reduction of these debts.

Since the Allied Nations have definitely abandoned their reparations claims on Germany, they are in agreement that their war debts to the United States should be greatly reduced,

if recognized at all,* and that settlement must wait upon world recovery. In Great Britain the opinion seems to prevail that definite steps toward currency stabilization cannot be taken until Great Britain knows how great a burden the resumption of war-debt payments may entail.

So far as outward appearances go, there has been little, if any, change in the attitude of the American public as a whole, or of the Congress, on the question of war debts. In other words, the prevailing sentiment still seems to be in favor of standing on the debt-funding agreements.

* Finland has continued to meet the payments required by its debt-funding agreement. But this is a small relief debt and not, strictly speaking, a war debt. Greece has recently made a partial payment.

MEASURES ADOPTED OR PROJECTED FOR FOREIGN-TRADE BETTERMENT

THE TRADE-AGREEMENTS PROGRAM

The reciprocal trade-agreements program now being carried out by the Government of the United States has been set up under the authority of the Act of Congress approved June 12, 1934. This Act comprises an amendment to the Tariff Act of 1930 and adds to Title III of the earlier Act a new part entitled, "Promotion of Foreign Trade".

The program is based on two fundamental assumptions: First, that a restoration of foreign trade is essential to the process of economic recovery in the United States. In Section 350-a of the Act, the expansion of foreign markets for United States products is described as "a means of assisting in the present emergency in restoring the American standard of living, in overcoming domestic unemployment, and the present economic depression, in increasing the purchasing power of the American public, and establishing and maintaining a better relationship among various branches of American agriculture, industry, and commerce". And, secondly, there is the assumption that the method of achieving a foreign-trade revival can be greatly aided through the removal or mitigation of the numerous and varied existing restrictions on the movement of goods in international commerce.

Inherent in the Act is also a recognition of the intimate relationship between our export and import trade — a factor that has been strongly emphasized in a preceding section of this Memorandum. The Act of June 12, 1934, recognizes the fundamental principle that our imports constitute for foreigners the source of purchasing power with which to pay for our exports.

Under the Act, the President is empowered to enter into trade agreements with foreign governments for the purpose of promoting a flow of American products into foreign markets through a reduction of the existing customs duties and other import restrictions in foreign countries, but the Act also authorizes him to modify existing customs duties and other import restrictions operative in the United States.

There are two important limitations placed by the Act upon the President's power to modify existing duties or import restrictions in the United States. The first is that no rate of duty may be decreased or increased by more than 50%, and the second, that no article can be transferred between the dutiable and the free lists.

In practice, this program envisages bilateral negotiations between the United States and individual foreign countries for the purpose of concluding trade agreements embodying customs concessions mutually granted by the two countries. The machinery set up for carrying out this program has been designed with a view to the most effective and expeditious negotiation of such trade agreements. All divisions of the Executive Branch of the Government which are in a position to contribute to this end are participating in the task.

The work is headed by the Department of State, which has the principal responsibility for the actual negotiation of trade agreements. A vast amount of preparatory work is being done by a series of interdepartmental committees consisting of representatives of the Departments of State, Commerce, Agriculture, and the Treasury and the United States Tariff Commission.

The primary responsibility for the preparation of material relating to the concessions which are to be asked by the United States of the other countries rests with the Department of Commerce. Similarly, primary responsibility for the preparation of material bearing on the concessions to be given by the United States rests with the Tariff Commission. The Department of State is primarily responsible for the preparation of the general provisions of the agreements.

The general plan on which the work is done is that the United States seeks to obtain from the country with which a particular trade agreement is being negotiated concessions relating to products in the exportation of which to the other country's market the United States is especially interested. Similarly, the other country seeks to obtain from the United States concessions with respect to products in which it is especially interested. While a precise calculation as to the relative importance to each of the two countries of the concessions received and granted is not possible, a real effort is made, so far as conditions allow, to create the conditions favorable to an increased flow of trade both ways in distinctive products of the contracting countries, and to establish a substantial measure of stability in the trade policy of each country toward the other, so that producers and merchants can plan ahead with assurance.

Moreover, the general bases upon which these agreements are being built are designed to bring about, in time, further enlargement of the trade possibilities of each country in the other's market, especially as general economic conditions improve. Outstanding among these general provisions is the reassertion of the most-favored-nation principle, so that each country will benefit from any concession that may be granted by the other in agreements with third countries. Recognizing that quotas and exchange controls can nullify the benefits sought by tariff reductions or assurances, the effort is made to write in provisions assuring fair and equitable treatment to each other's trade under any such quantitative restrictions that may be maintained on importations or remittances.

Up to April 25, 1936, twelve such reciprocal trade agreements had been signed by the United States, namely, with Canada, with seven governments of Latin America (Cuba, Haiti, Brazil, Colombia, Honduras, Nicaragua, and Guatemala), and with four governments of Europe (Belgium, Sweden, Netherlands and the Indies, and Switzerland). Taken together, these countries have in the past accounted for nearly one-third of the total American foreign trade. Negotiations for similar trade agreements are in various stages of advancement with five additional governments (France, Spain, Finland, Costa Rica, and El Salvador).

Nine of the twelve agreements concluded are already in effect, with the tenth, that with Colombia, due to become operative on May 20. However, since the majority of these agreements were not completed and brought into effect until the last half of 1935 or the early months of 1936, the period of their operation is as yet too short to allow a fair gauge of their potential results. The only agreement that has been in operation as much as a full year, that with Cuba, has been followed by a marked revival of trade in both directions, to the benefit of many producers in each country who had come to depend upon the other market. The value of Cuban-American trade during 1935 was about one-third greater in each direction than during 1934, and very much larger than during the period preceding the initiation of the agreement in September 1934. American agricultural as well as industrial exports have shared in this improvement. For most of the other agreements concluded, the early trade returns thus far available afford encouraging indications of the ultimate benefits to come. The increases in trade with each other since the agreements came into operation have usually been greater than with foreign countries generally.

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